SHOULD IMMEDIATE ANNUITIES BE A TOOL IN YOUR RETIREMENT PLANNING TOOLBOX?

by

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Foreword

78 million Baby Boomers started to turn age 65 in the year 2011. These Baby Boomers will need to decide how to generate income during their retirement. Income can be generated from their investment portfolio or through the purchase of low-cost immediate annuities. This short story explores the pros and cons of utilizing low-cost immediate annuities to generate retirement income. This short story will give you enough information to make your own well-informed decision on whether or not to use low-cost annuities to generate your retirement income.

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CHAPTER 1

Introduction

Once an investor enters the retirement phase, the key objective is to have enough money to meet living expenses for the rest of your life. The conventional method for accomplishing this is to withdraw no more than 4% of your portfolio each year with an annual inflation adjustment. [1] The good news about this option is that your heirs will receive an inheritance if you do not outlive your money. The bad news is that you might outlive your money and you will not leave an inheritance for your beneficiaries.

An alternative to the conventional approach is to exchange part of your portfolio for an immediate annuity which pays you a fixed monthly income for the rest of your life. The good news about this approach is that you will never outlive your money. The bad news is you will not leave as large of an inheritance to your beneficiaries.

My goal in this short story is to further explore the immediate annuity option so ordinary investors can determine if this option can help them to achieve their financial goals.

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CHAPTER 2

Immediate Annuity Definition

There are many different types of annuities. The annuity world can be split into two distinct groups. In my opinion, the first group can be thought of as Glenda, the Good Witch of the North. This first group is immediate or fixed annuities. With this type of annuity, an investor enters into a contract with an insurance company. The investor pays the insurance company a lump sum of money. In exchange for this lump sum of money, the insurance company agrees to pay the investor a fixed amount every month until the investor dies. These monthly payments begin immediately after the contract is completed, hence the name "immediate annuity".[2]

There are many types of immediate annuities. A single life policy pays the annuity as long as the investor lives. There are also joint survivor type annuities where the annuity pays until the last surviving person dies. Of course, these joint survivor type annuities pay a lower amount each month because the odds favor one of the two parties living longer than just one person.[3] In this short story, we will only be using single life type annuity contracts (for ease of illustration).

The amount of monthly income an immediate annuity pays is a function of current interest rates and expenses of the insurance company. Investors can use several web sites to shop for the highest paying immediate annuity.[4] In April 2007, the following rates were found assuming a $100,000 immediate annuity was purchased by a male:[5]

Age	Annual Payout Ratio
40	6.00%
50	6.52%
60	7.34%
65	8.29%
70	9.26%
80	12.94%
90	21.00%

For example, a 65 year old male would receive 8.29% of $100,000 or $8,290 each year until he dies. The payout ratio increases with age because life expectancy decreases with age and the insurance company is required to pay the annuity for fewer years.

Investors shopping for immediate annuities are encouraged to search for reliable and low cost providers such as Vanguard, Fidelity, Berkshire Hathaway, and TIAA-CREF.[6]

In my opinion, the second group of annuities should be thought of as the Wicked Witch of the West. This group is the variable annuities group. The general concept of variable annuities is to increase the odds that investors will receive a higher payout than immediate annuities because the insurance company invests in stocks or bonds selected by the investor. In theory, this concept is fine. In practice, high costs and complexity make these poor deals for investors.[7,8,and 9]

The sellers of variable annuities have intentionally made them difficult to understand and have skillfully hidden all the fees and charges in such a manner no ordinary investor would ever understand them.[10]

Warren Buffett is probably the greatest investor of all time. He is famous for one of his quotes, “Never invest in something you don’t understand”. Buffett escaped the dramatic losses incurred by Tech stock investors in 2000 because he did not understand and therefore never invested in Tech stocks.

I recommend that ordinary investors apply the Warren Buffett approach to variable annuities….don’t invest in something you probably will never understand!

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CHAPTER 3

Social Security and Defined Benefit Pension Plans

Social Security and traditional defined benefit pension plans are types of annuities. Social Security pays monthly income to the recipient until death. It represents an immediate annuity on the distribution side of the equation, but not on the purchasing side of the equation. Because our Social Security system is a “pay as you go” system, the payroll deduction from workers goes immediately out of the U.S. Treasury to pay the current recipients.

Traditional defined benefit pension plans are also a form of an annuity. The company contributes funds to its pension plan during the worker’s lifetime. Once the worker retires, he receives a monthly check until his death.

Many Americans are exposed to the annuity concept through the Social Security system or traditional pension plans.

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CHAPTER 4

Conventional Portfolio Distribution

When you are saving and investing for retirement, you are in the accumulation phase of investing. Once you enter retirement, you are in the distribution phase of investing.

The conventional method of paying retirement income is to withdraw 4% of your portfolio's value each year for living expenses. You can also increase the 4% amount by the rate of inflation each year. The 4% Rule comes from many academic studies.[11] Most of these studies recommend a 60:40 stock to bond ratio in your portfolio. If you withdraw more than 4% per year, you run the chance of outliving your money. If you are interested in learning more about the 4% Rule, see my short story titled ***Are You Using the Right Rules to Plan Your Retirement***. [12]

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CHAPTER 5

Immediate Annuities as an Alternative

If the 4% conventional safe withdrawal rate works, why consider immediate annuities?

Following the 4% Rule does not guarantee you will not run out of money during retirement. With life expectancies increasing, you might live much longer than the average and therefore run out of money.

The 4% Rule also assumes that stocks and bonds will have the save average return and variation in returns that we have seen historically. The decades of the 1980's and 1990's blessed us with double digit compound returns for the S&P 500 stock index. The 1990's were particularly generous giving us 18% compounded returns in the S&P 500. [13]

Reviewing hundreds of years of stock market history would suggest these very high return periods will be followed by periods of lower returns. Billionaire Warren Buffet, probably the most successful investor of all time, has predicted single digit returns for the U.S. stock market.[14] Jack Bogle, founder of The Vanguard Group, also predicts single digit returns.[15] William Bernstein, author of The Four Pillars of Investing, is predicting compound returns of 6.4% versus the S&P 500 average for the last 70 years of 11%. If we experience lower stock market returns in the future, investors who follow the 4% Rule may run out of money since the rule is based upon higher returns.

Another factor which might favor immediate annuities is the characteristics of the retired couple. A predominant characteristic is a man who is interested in investing and a wife who is not. The odds are the wife will live approximately 8 years longer than the husband. If the man has married a much younger woman, she may live 20 years longer than the husband, depending on her age. The husband wants to provide for his wife after he is gone, but does not trust others to manage his money when he is gone. If the husband partially annuitizes their portfolio, the surviving wife will be guaranteed to receive a monthly check if the annuity is in her name, or if they purchase a joint survivor type immediate annuity.

Pooling-of-risk by insurance companies might be another reason to partially annuitize a portfolio. An individual investor has to plan for the worst case of a single life. For example, a single investor might plan for a life expectancy of 95. An insurance company pools the risk by having many annuity customers who have an average life expectancy of 78 years old. The insurance company saves money on the people who die before age 78. They use the money from the early death customers to pay off the people who live past age 78. Since life expectancy determines how long you must pay out, an insurance company can pay a larger monthly check than a single individual.[16]

Another possible scenario for immediate annuities might be a 70 year old who wants enough income for the rest of his life plus give away money to his beneficiaries. This person could purchase an immediate annuity which assures his living expenses are covered for the rest of his life. He could then take the balance of his portfolio and gift it to his children.

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CHAPTER 6

Previous Research

Has previous research shown that immediate annuities improve the probability of not outliving your money?

Fortunately, some excellent research has already been conducted regarding the use of immediate annuities during retirement. We will next review some of this existing research.

In January, 2001, Professor Moshe Milevsky published his paper titled ***Optimal Annuitization Policies: Analysis of the Options***. [17] Milevsky concluded that investors who self-annuitize their portfolio (use the 4% Rule) can beat the rate of return from immediate annuities until around age 75 to 80. He advocates "doing it yourself and then switch" at age 75 to the use of immediate annuities if the investor has no strong desire to leave an inheritance for his beneficiaries. Milevsky said there are two possible exceptions for waiting until age 75 to start immediate annuities.

The first exception is if interest rates go extraordinarily high which means cheap immediate annuities. The second exception is when the investor is much healthier than the general population.

In December, 2001, Ameriks, Veres, and Warshawsky published their paper titled ***Making Retirement Income Last a Lifetime***. [18] The authors used Monte Carlo analysis to determine the impact of adding immediate annuities to a retirement portfolio. The key inputs to their Monte Carlo model were:

- 65 Year old male.
- Immediate annuity payout of 9.05% each year.
- One percent expense ratio on all portfolio investments.
- Asset allocation between S&P 500, Intermediate term Government bonds, and cash represented by 30-day T-bills. For example, 60-30-10 is 60% S&P 500, 30% Intermediate bonds, and 10% cash.
- Randomly select returns from the years 1946-1999.
- Withdrawal rate of 4.5%.
- Test 3 levels of immediate annuities (0%, 25%, and 50%).

The authors reported their Monte Carlo results in terms of probability of failing to have the portfolio generate enough income during retirement. I converted their results to probability of success to be consistent across all studies illustrated in this short story. The 30 year results were:

Annuity Level	20-50-30 Conservative Portfolio	40-40-20 Balanced Portfolio	60-30-10 Growth Portfolio	85-15-10 Aggressive Portfolio
0%	33%	76%	87%	92%
25%	53%	85%	92%	95%
50%	81%	94%	97%	97%

The authors intentionally chose a 4.5% withdrawal rate versus using the 4% Rule. They wanted to see if investors could increase their income by using immediate annuities.

The first observation from the chart is that a 4.5% withdrawal rate is not sustainable (without using immediate annuities), unless the investor chooses the Aggressive Portfolio.

The second observation is that investors should target the Growth Portfolio. This portfolio with a 60:30:10 asset allocation is the same as the conventional 60:40 (if we add bonds and cash together as one item) asset allocation used by pension funds. Most of the research which prompted the 4% Rule found the 60:40 asset allocation was in the optimal risk-to-reward range.

The third observation is that adding immediate annuities does help improve the chances of not outliving your money. The minimal level of acceptance is somewhat subjective (is it 90%, 95%, or 100% probability of success?). Adding immediate annuities to the mix does improve your chances.

The authors also looked at the extreme case where a 65 year old lived to be 105:

Annuity Level	20-50-30 Conservative Portfolio	40-40-20 Balanced Portfolio	60-30-10 Growth Portfolio	85-15-10 Aggressive Portfolio
0%	3%	45%	73%	85%
25%	6%	54%	79%	89%
50%	18%	67%	86%	93%

Adding immediate annuities increased the longevity of the retirement income stream, but only the Aggressive Portfolio with 50% annuitization was able to succeed more than 90% of the time.

The authors concluded that fixed annuities should be considered as an option for retirement planning.

In February, 2003, Chen and Milevsky published their paper titled ***Merging Asset Allocation and Longevity Insurance: An Optimal Perspective on Payout Annuities***. [19] The goal of this research was to develop a financial model which reflected both financial market risk and longevity risk. They concluded that the optimal allocations across assets and financial products are influenced by many factors:

- Age.
- Risk aversion.
- Subjective probability of survival.
- Need to leave an inheritance.
- Expected risk and return trade-offs of various investments.

In November, 2003, William Reichenstein published his article titled ***Allocation During Retirement: Adding Annuities to the Mix***. [20] Reichenstein used the case study of a 65 year old female to illustrate the results of adding immediate annuities to her retirement plan. Reichenstein's case study found the same level of benefits from adding immediate annuities as described in the 2001 Ameriks, Veres, and Warshawsky paper described above. Reichenstein said the three most important factors for deciding to annuitize are:

- Life prospects.
- Trade-off between leaving inheritance versus family taking care of you if you run out of money.
- Social Security and traditional pension income drive less need to annuitize.

In July, 2003, Peter Katt published his article titled ***Annuities: The Good, the Bad, and the Ugly***. [21] Katt pointed out that poor health shortens life expectancy and increases immediate annuity payments. He recommended that people with poor health seek out immediate annuities designed for those in poor health. He concluded that immediate annuities do the job they are intended for…..providing guaranteed income in exchange for the investor giving up principal.

In September, 2006, Walter Updegrave published an article titled ***An Income Plan That's Built to Last***. [22] Updegrave pointed out that investors have three choices at retirement:

1) Do-it-yourself using 4% Safe Withdrawal Rate
2) Convert your retirement portfolio to 100% immediate annuities.
3) Use a combination of #1 and #2.

Updegrave used a graph to show the dramatic impact of adding immediate annuities when you live longer than 90 years old. Summarizing his graph into a table shows the probability of success for various ages and levels of immediate annuities:

Age	0% Immediate Annuity	25% Immediate Annuity	50% Immediate Annuity
90	95%	98%	99%
95	80%	95%	98%
100	68%	83%	96%

The conclusion from Updegrave's results is the addition of immediate annuities has a big impact if you live longer than 90 years old. He concluded that immediate annuities should be considered as an option in retirement financial plans.

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CHAPTER 7

Recent Monte Carlo Analysis

Would recent Monte Carlo modeling with today's financial conditions continue to indicate that immediate annuities improve the probability of not outliving your money?

A Monte Carlo analysis is a mathematical model in which the inputs can be varied each time a simulation is run. For example, stock market returns can vary each year. By running the Monte Carlo simulation thousands of times, you can establish the likely probability of different outcomes. If you interested in learning more about Monte Carlo financial modeling, see my short story titled ***Are You Using the Right Rules to Plan Your Retirement?***[23]

A Monte Carlo financial model for analyzing the impact of adding immediate annuities to a conventional stock and bond portfolio was constructed in Excel© using an add-on package called RiskAMP from Structured Data, LLC.[24] The inputs and the rationale for each input to the model are shown below:

Input	Base-line	Rationale
Expected Stock Return Before Expenses	10.81%	Compounded Return of Wilshire 5000 Last 15 Years
Stock Return Expenses	0.18%	Vanguard Index 500 or Total Stock Market Fund
Expected Stock Return	10.63%	Gross Return Minus Expense Ratio
Stock Return Sigma	17.61%	Wilshire 5000 Last 15 Years
Expected Bond Return Before Expenses	6.50%	Compounded Return of Lehman Bond Index Last 15 Years
Bond Return Expenses	0.18%	Vanguard Total Bond Index Fund
Expected Bond Return	6.32%	Gross Return Minus Expense Ratio
Expected Bond Sigma	5.32%	Lehman Bond Index Last 15 Years
Expected Inflation	3.00%	Historic Norm
Beginning Portfolio Value	$2,000,000	$80,000 Desired Income Times 25 (4% Rule)
Immediate Annuity %	0.00%	Options in Study Include 0%, 25%, and 50% Annuitization
Percent Stocks	60.00%	Conventional 60:40 Stock to Bond Allocaton
Percent Bonds	40.00%	Conventional 60:40 Stock to Bond Allocaton
Initial Withdrawal Rate	4.00%	Assume 4% Rule
Annuity Payout Rate	8.29%	From ImmediateAnnuities web site in April 2007, 65 Year Old Male
Starting Age	65	Conventional Retirement Age, Consistent with Previous Research Studies
Ending Age	95	30 Year Retirement Period

I chose to use the return over the last 15 years for the Wilshire 5000 and Lehman Bond Fund. The returns for these indexes were found on Vanguard's web site for the Index 500

fund and Total Bond Market index fund. The standard deviation (sigma) for these returns was calculated from the yearly returns.

I assumed the investor used Vanguard's index funds with a relatively low annual expense ratio of 0.18% per year.

The 4% Rule says the amount of money you need at the start of retirement is twenty-five times the desired annual income. For a desired annual income of $80,000…..this means the portfolio must be 25 x $80,000 = $2,000,000.

The annuity payout rate was found from the web site shown in the chart.

The baseline case was for a 65 year old male. Sixty-five was chosen to because it is often used as a "normal retirement" age and it was used in the previous research we reviewed above.

A 60:40 stock to bond portfolio was selected for this analysis. Based upon previous research, this is a good portfolio for retirement.

Seven scenarios or cases were modeled using the Monte Carlo analysis. One-thousand runs of the model were used to calculate the probability of success for each case. The results of the Monte Carlo analysis were:

Input	Base-line	Case #1 1% Expense Ratios	Case #2 Stock Return Drops by 2%	Case #3 Stock & Bond Returns Drop by 2%	Case #4 Withdrawal Rate Increased to 4.5%	Case #5 Withdrawal Rate Increased to 5%	Case #6 Retirement Age from 65 to 60	Case #7 End at Age 100 Versus 95
Expected Stock Return Before Expenses	10.81%	10.81%	8.81%	8.81%	10.81%	10.81%	10.81%	10.81%
Stock Return Expenses	0.18%	1.00%	0.18%	0.18%	0.18%	0.18%	0.18%	0.18%
Expected Stock Return	10.63%	9.81%	8.63%	8.63%	10.63%	10.63%	10.63%	10.63%
Stock Return Sigma	17.61%	17.61%	17.61%	17.61%	17.61%	17.61%	17.61%	17.61%
Expected Bond Return Before Expenses	6.50%	6.50%	6.50%	4.50%	6.50%	6.50%	6.50%	6.50%
Bond Return Expenses	0.18%	1.00%	0.18%	0.18%	0.18%	0.18%	0.18%	0.18%
Expected Bond Return	6.32%	5.50%	6.32%	4.32%	6.32%	6.32%	6.32%	6.32%
Expected Bond Sigma	5.32%	5.32%	5.32%	5.32%	5.32%	5.32%	5.32%	5.32%
Expected Inflation	3.00%	3.00%	3.00%	3.00%	3.00%	3.00%	3.00%	3.00%
Beginning Portfolio Value	$2,000,000	$2,000,000	$2,000,000	$2,000,000	$2,000,000	$2,000,000	$2,000,000	$2,000,000
Immediate Annuity %	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
Percent Stocks	60.00%	60.00%	60.00%	60.00%	60.00%	60.00%	60.00%	60.00%
Percent Bonds	40.00%	40.00%	40.00%	40.00%	40.00%	40.00%	40.00%	40.00%
Initial Withdrawal Rate	4.00%	4.00%	4.00%	4.00%	4.50%	5.00%	4.00%	4.00%
Annuity Payout Rate	8.29%	8.29%	8.29%	8.29%	8.29%	8.29%	7.52%	8.29%
Starting Age	65	65	65	65	65	65	60	65
Ending Age	95	95	95	95	95	95	95	100
Probability of Success with 0% Immediate Annuity	93%	83%	83%	72%	85%	73%	87%	72%
Probability of Success with 25% Immediate Annuity	98%	94%	96%	85%	92%	81%	90%	85%
Probability of Success with 50% Immediate Annuity	100%	99%	100%	98%	98%	90%	98%	98%

The baseline case came out as expected using the 4% Rule. In 93% of the simulation trials, the investor was able to reach age 95 and not outlive his money.

Case #1 was simply increasing the annual expense ratio from Vanguard's 0.18% to 1.0%. I was somewhat surprised this was enough to make our chances of success fall below 90% (83% result in the table). Jack Bogle was right when he said costs matter, and investors should select low cost index funds.[25] Adding 25% fixed annuities to the mix raised the chances of success to 98%. Investors should take heed at how important annual expense ratios are!

Case #2 dropped the expected stock return by 2%. Many forecasters are predicting lower stock market returns in the future. The chances of success with no immediate annuities fell from 93% to 83% from by decreasing the stock return by 2%. Adding 25% immediate annuities raised the chances of success from 83% to 94%.

Case #3 dropped both the stock and bond return by 2%. This lowered the chances of success from 93% to 72%. An addition of 50% immediate annuities was required to increase the chances of success to 98%.

Case #4 increased the withdrawal rate from 4% to 4.5%. This dropped the chances of success from 93% to 85%. An addition of 25% immediate annuities increased the chances of success to 92%.

Case #5 increased the withdrawal rate from 4% to 5%. This dramatically dropped the chances of success from 93% to 73%. It required an addition of 50% immediate annuities to increase the chances of success to 90%. This case can represent two different life situations. In the first situation, an investor can increase their withdrawal rate from 4% to 5% if they add 50% immediate annuities. In the second situation, the investor has reached age 65 and does not have enough assets accumulated under the 4% Rule. Immediate annuities may help those investors who can't save enough to meet the 4% Rule.

Case #6 is changing the retirement age from age 65 to 60. This investor needs to add 25% annuities to increase from an 87% to 90% chance of success.

Case #7 changes the retirement period from 65-95 to 65-100. It requires 50% immediate annuities to increase from a 72% to 98% chance of success.

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CHAPTER 8

Waiting until Age 75

Many studies suggest waiting until age 75-80 before starting to buy immediate annuities. What would be a typical example of a man who waits until age 75 to purchase immediate annuities?

Let's take a look at our baseline case outlined above. Assume that back in 1997 our example man started retirement at age 65 with a desired income of $59,530 (which is $80,000 in 2007 assuming a 3% inflation rate). He saved and met the 4% Rule, so he started retirement at age 65 with a portfolio worth $1,488,250 (25 times $59,530). Using Monte Carlo analysis, we find that in the year 2007, when he is now 75 years old, his portfolio has an 80% chance of being worth $1,625,000.

In 2007, the annuity payout rate for a 75 year old male is 11.016%. Our example man speculates that he will live to be 100 at most. Assuming a 3% inflation rate, he will need an income of $168,000 at age 100 to equal his 2007 income of $80,000.

If he annuitizes $1 million, he will receive $110,160 annually until his death. He figures he will save some of this income the next five years or so, and then use this savings to make up for any shortfalls as inflation steadily reduces his income. This leaves him $625,000 is invest. If he invests in a 60:40 stock-to-bond ratio portfolio, using simple compounding of about 9%, he could accumulate $5.4M at age 100. He can leave this portfolio for his heirs.

As this example case demonstrates, a 75 year old has many options and a different viewpoint at age 75. The annuity payout rate of 11.0% is much higher than the 8.3% available to a 65 year old. This higher annuity income rate plus less years of expected life causes a different viewpoint and different options for 75 year olds.

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CHAPTER 9

Insurance Company Bankruptcy

If I purchase an immediate annuity from an insurance company, do I have any protection if the insurance company declares bankruptcy?

Although it varies by state, most states insure immediate annuity contracts up to a maximum of $100,000.[26] Check with your state and verify what the maximum limits are.

For this reason, many financial advisors suggest not exceeding $100,000 per company you buy the annuity from. For example, suppose you want to buy $250,000 of immediate annuities. You would buy $100,000 from Company A, $100,000 from Company B, and $50,000 from Company C. This strategy helps you avoid losing money if an insurance company declares bankruptcy.

*****

CHAPTER 10

Immediate Annuity Owners

Who buys immediate annuities?

People under age 65 largely do not see the need for immediate annuities. People under age 65 only purchases 22% of immediate annuities. Nearly half of this group who buy immediate annuities are between the ages of 60 and 64. Most people under age 65 are pre-occupied with the accumulation of wealth, not the liquidation of it.[27]

78% of immediate annuity buyers are over age 65. Of these, 61% are over age 70. The average annuity buyer is 70.5 years old. Age 70 is the most common age at purchase for male and female buyers.[28]

Only 20% of immediate annuity buyers are working, 80% are retired. Retired immediate annuity buyers received income from an average of 3.4 sources. Annuities rank second, behind Social Security. This suggests that many retirees who purchase immediate annuities view them as an important source of income.[29]

Immediate annuities represent less than 5% of the more than $200 billion worth of all types of annuities that are sold annually.[30]

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CHAPTER 11

Summary

My first conclusion is that Behavioral Finance plays a role in the decision to purchase immediate annuities. Behavioral Finance assumes that people do not always act in a perfectly rational fashion. Based upon the historical data, many rational investors should choose to partially annuitize. The reality is that very few people utilize immediate annuities. I suspect people don't use immediate annuities for the following reasons:

1) Strong desire to leave an inheritance for their children.
2) Annuities are perceived to be too expensive and too hard to understand.
3) Belief that family members will take care of you if you run out of money.
4) Lack of low cost easy to understand inflation protected annuities.
5) Fear of death prevents thinking about running out of money.

If you are interested in learning more about the field of Behavioral Finance, see my short story titled ***How to Use Psychology to Achieve Your Financial Goals***.[31]

The Monte Carlo analysis conducted for this paper demonstrated you probably don't need to worry about using immediate annuities if you have the following beliefs:

1) You will accumulate enough money to meet the minimum requirements of the 4% SWR Rule.
2) You believe future stock and bond returns will be as high as the historic averages.
3) You use low-cost index funds with expense ratios below 0.18%.
4) You have a strong desire to leave an inheritance for your children.

You should consider using immediate annuities if you have the following beliefs:

1) You will not accumulate enough money to meet the 4% SWR Rule.
2) You believe future stock and bond returns will be lower in the future than the historical averages.
3) You do not use low-cost index funds with expense ratios below 0.18%.
4) You do not have a strong desire to leave an inheritance for your children.
5) You believe you will live to be at least 100 years old.

My over-all conclusion is the same as the other researchers noted above…..immediate annuities should be considered as an option for retirement planning.

Unfortunately, the decision whether or not to use immediate annuities is a difficult one because so many factors are involved. As we saw from the Monte Carlo analysis, slight changes in the inputs to the Monte Carlo model can create large differences in the results.

I am also going to give the same advice the Good Witch of the North gave to Dorothy. ***Follow the Yellow Brick Road***……only investigate immediate annuities….do not stray off the Yellow Brick Road into the land of variable annuities…..or the Wicked Witch of the West will get you! Many sales personnel will immediately try to steer you away from immediate annuities towards variable annuities, because the sales person makes a lot more money from selling you variable annuities.

My recommendation is to never deal with a sales person regarding immediate annuities. Instead, deal directly with one of the low cost providers like Vanguard, Fidelity, TIAA-CREF, or Berkshire Hathaway.

Professor Moshe Milevsky is one of the early researchers in the field of using immediate annuities. From the results of his research, he recommends that people should wait until age 75-80 before purchasing immediate annuities. Since the first Baby Boomers were

born in 1946, they won't hit age 75 until the year 2021. If Professor Milevsky is correct, we may see a surge in the usage of immediate securities starting around the year 2021.

My prediction is that as we get further along in the Baby Boomer retirement wave, we will start to see the popular personal finance magazines start to commonly recommend partial annuitization. In the January 2012 issue of SmartMoney magazine, they recommend 10% annuitization for a 65 year old. [32]

I predict we will also begin to see retirement calculators which allow immediate annuities as an option. We will probably see the large mutual fund companies expand their existing retirement calculators to include an option for immediate annuities.

If you don't feel comfortable evaluating the use of immediate annuities by yourself, you can get professional help. You can read my short story titled ***How to Find a Good Financial Planner.***

If you would like to know how the use of immediate annuities fits into the over-all financial planning process, you can read my short story titled ***How to Read Your Way to Financial Wealth.***

Hopefully you now have enough information to make your own well-informed decision about immediate annuities and their use as a tool in your retirement planning toolbox.

"I advise you to go on living solely to enrage those who are paying your annuities. It is the only pleasure I have left."
----Voltaire

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Recommended Reading

Index Mutual Funds: How to Simplify Your Financial Life and Beat the Pros by Dale Maley.

The Bogleheads' Guide to Investing by Taylor Larimore, Mel Lindauer, and Michael LeBoeuf

Retirement Bible by Lynn O'Shaughnessy

Getting Started in Annuities by Gordon Williamson

Yes, You Can Still Retire Comfortably! By Ben Stein and Phil DeMuth

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Web Sites

ImmediateAnnuities.com has instant quotes for immediate annuities.

Vanguard.com has educational materials including immediate annuities.

Fidelity.com has information on immediate annuities.

BRKDirect.com has quotes for immediate annuities.

TIAA-CREF.com has information on immediate annuities.

Bogleheads.org is an online forum. This forum focuses on Vanguard investments with many lively and informational discussions about investing during both the accumulation and distribution phases of life. Also covers whether to use immediate annuities for retirement planning.

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Dale C. Maley

Author Spotlight

Dale C. Maley is the author of the book ***Index Mutual Funds: How to Simplify Your Financial Life and Beat the Pros***. He was also a contributing author to Chapter 18 in the 2009 book ***The Bogleheads Guide to Retirement Planning***. Dale is a very successful private investor who has been a student of Financial Planning and Investing for over 32 years.

He was trained as an engineer at the University of Illinois and has been a practicing engineer for 33 years. His accomplishments as an engineer include the granting of 16 U.S. Patents and authorship of over 535 professional technical papers. He is also a member of the International Society of Automotive Engineers and the Society of Manufacturing Engineers.

Dale earned an MBA (Masters Degree in Business Administration) degree from Illinois State University. Dale became a Registered Financial Advisor in the State of Illinois in 2006 and is currently launching his business as a fee-only financial planner. He is President of Maley Financial Planning.

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Also by Dale C. Maley

Index Mutual Funds: How to Simplify Your Financial Life and Beat the Pro's
How Asset Allocation Can Help You Achieve Your Financial Goals
Frequently Asked Questions & Answers about ETF's and Index Funds
Why We Don't Save Enough for Retirement and How You Can Save More
Are You Using the Right Rules to Plan Your Retirement?
How to Use Psychology to Achieve Your Financial Goals
Should Immediate Annuities Be a Tool in Your Retirement Planning Toolbox?
Who Wins the Variable Annuity Versus Mutual Fund Battle?
Will Your Children or Uncle Sam Inherit Your Estate?
What Are the Requirements for Becoming a Financial Planner?
Sell My Stocks Before the Baby Boomers Crash the Market?
How Do I Determine If I Have Saved Enough to Retire?
Don't Max Out My 401K?
Will Reverse Mortgages Be the Salvation of Baby Boomer Retirees?
Do I Need Ten, Twenty, or Thirty Times My Income to Retire?
How to Find a Good Financial Planner
Total Market or Slice-n-Dice for My Investment Portfolio?
What Safety Factor Are You Using for Your Retirement Plan?
How Much Income Do I Really Need in Retirement?
What Lessons Can We Learn from the Crash of 2008?
How to Invest for Retirement after the Crash of 2008
Rules-of-thumb or Retirement Planning Software?
Is Portfolio Rebalancing Worth It?
Do I Need Umbrella Insurance?
Got My First Job and How Do I Handle the 401K?
Are Black Swans Really Harmful to Ordinary Investors?
Should My Asset Allocation Include My Pension and Social Security?
Should I Pay Off My Mortgage Early?
How Does My Asset Allocation Compare to Everyone Else?

How Do I Maximize Retirement Income From My Portfolio?

Is Saving 10% of My Gross Income Good Enough?

Contribute to My Bad 401K or Go Taxable?

Do I Need an Investment Policy Statement?

Do I Need Long-Term Care Insurance?

Do I Need Long-Term Disability Insurance?

How to Read Your Way to Financial Wealth

How Do I Select the Correct Risk Level for My Portfolio?